Supreme Court, U.S.
FILED
SEP 20 2010
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No. 10-398

IN THE

Supreme Court of the United States

CELLCO PARTNERSHIP D/B/A VERIZON WIRELESS

Petitioner,

v.

KEITH LITMAN, ET AL,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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September 20, 2010

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QUESTION PRESENTED

Whether the Federal Arbitration Act ("FAA") preempts States from conditioning the enforcement of arbitration agreements on the availability of class-wide arbitration.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioner in this case is Cellco Partnership d/b/a Verizon Wireless. Cellco Partnership d/b/a Verizon Wireless has four partners. Two of the partners, representing 55% of the interest in Cellco, are ultimately owned by Verizon Communications Inc. ("Verizon"). These partners are: Bell Atlantic Mobile Systems, Inc. and GTE Wireless Incorporated (collectively, the "Verizon Partners"). None of the Verizon Partners is publicly held. Two of the partners, representing 45% of the interest in Cellco, are ultimately owned by Vodafone Group Plc ("Vodafone"). These partners are: PCS Nucleus, L.P. and JV PartnerCo, LLC (collectively, the "Vodafone Partners"). None of the Vodafone Partners is publicly held.

Verizon is a publicly held Delaware corporation. Vodafone is a publicly held British corporation. Neither Verizon nor Vodafone has a parent company, and no publicly held company has a 10% or greater ownership in either entity.

Respondents are Keith Litman and Robert Wachtel.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Cellco Partnership d/b/a Verizon Wireless ("Verizon Wireless") respectfully submits this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit.

OPINIONS BELOW

The decision of the United States Court of Appeals for the Third Circuit is unreported but is available at 2010 WL 2017665, and is reprinted in the Appendix ("App.") at 1a-7a. The trial court's decision granting Petitioner's petition to compel arbitration is unreported but is available at 2008 WL 4507573, and is reprinted at App. 8a-28a.

JURISDICTION

The United States Court of Appeals for the Third Circuit rendered its decision on May 21, 2010. App. 1a. This Court granted the Petitioner's application for an extension of time to file a petition for a writ of certiorari and extended the time to and including September 20, 2010. Order, Application No. 10A129 (July 30, 2010). This Court has jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of the United States Constitution (U.S. Const., Art. VI, cl. 2), provides in pertinent part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 2 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 2, provides in pertinent part:

> A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, . . . or an agreement in writing to submit to arbitration an existing controversy arising out of such contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

STATEMENT

This petition presents a recurring issue of great importance: whether the Federal Arbitration Act preempts States from conditioning the enforcement of arbitration agreements on the availability of class-wide arbitration. The Court examined—but did not resolve—this issue over twenty-five years ago. *See Southland Corp. v. Keating*, 465 U.S. 1, 17 (1984). Since then, the issue has only grown in importance as retail arbitration agreements have become ubiquitous; indeed, this issue could affect "hundreds of millions of arbitration

agreements." Amicus Brief of CTIA – The Wireless Ass'n as Amicus Curiae in Support of Petitioner at 7, 16, *AT&T Mobility LLC v. Concepcion*, 130 S. Ct. 3322 (2010) (No. 09-893).

This petition satisfies the Rule 10 standard for granting certiorari. The Court has already granted certiorari in *Concepcion*, a virtually identical case presenting the same overarching question of federal law. Indeed, *Concepcion* and this case are identical in all material respects. Both involve: standard-form retail contracts for wireless service; putative class-actions under state law alleging that a wireless carrier imposed unlawful fee increases; motions to compel arbitration in accordance with arbitration agreements containing class-arbitration waivers; and state-court decisions holding class-arbitration waivers unconscionable and unenforceable. In fact, the state-court decision at issue here (*Muhammad v. County Bank of Rehoboth Beach, Del.*, 912 A.2d 88 (N.J. 2006)) expressly relies upon the state-court decision at issue in *Concepcion* (*Discover Bank v. Super. Ct.*, 113 P.3d 1100 (Cal. 2005)). *See Muhammad*, 912 A.2d at 99. At a minimum, therefore, the Court should "hold" this petition pending its decision in *Concepcion*. *See Stutson v. United States*, 516 U.S. 163, 181 (1996) (Scalia, J., dissenting) ("We regularly hold cases that involve the same issue as a case on which certiorari has been granted[.]").

However, this petition should be granted in its own right as it presents an additional theory of preemption under the FAA that is not the principal focus of *Concepcion*—a theory that could fully resolve both cases. Section 2's savings clause exempts from

preemption only those state law doctrines that serve as grounds "for the revocation of any contract." 9 U.S.C. § 2. To fall within this savings clause, state law must be both (1) a ground for "revocation" and (2) applicable to "any contract." *Concepcion* focuses principally on the latter requirement. This case examines the former as well, raising the issue whether "grounds for revocation" include only state-law doctrines relating to the "making of an agreement to arbitrate." *Id.* § 4. Under this theory, both *Muhammad* and *Discover Bank* fall outside the ambit of Section 2's savings clause because they refuse to enforce arbitration clauses based upon the alleged unfairness of bilateral arbitration itself. Consideration of this additional theory of preemption is thus necessary for a full understanding of Section 2's preemptive sweep. A grant of certiorari is warranted here to allow the Court to address FAA preemption in a comprehensive manner this Term.

1. The Federal Arbitration Act.

Congress enacted the FAA to "revers[e] centuries of judicial hostility to arbitration agreements." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510 (1974). The FAA's primary "purpose was to place an arbitration agreement 'upon the same footing as other contracts, where it belongs,' H.R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924), and to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985). The FAA had a separate goal of promoting arbitration as a streamlined, efficient alternative to judicial process. It thus established "a liberal federal policy favoring arbitration agreements."

Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983). In establishing this policy, Congress "had the needs of consumers, as well as others, in mind." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995) (citing S. Rep. No. 536, 68th Cong., 1st Sess., 3 (1924) (stating that the Act, by avoiding "the delay and expense of litigation," will appeal to "corporate interests [and] . . . individuals")).

To accomplish these goals, Congress made arbitration agreements "valid, irrevocable, and enforceable" as a matter of federal law, "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. It is "well-established" that Section 2 preempts otherwise applicable state law. *Preston v. Ferrer*, 552 U.S. 346, 353 (2008).

Section 2's savings clause preserves state law only if it serves as a ground "for the revocation of any contract." 9 U.S.C. § 2. State law thus can nullify an arbitration clause only if it is both (1) a ground for "revocation" and (2) applicable to "any contract." The *Concepcion* case concerns the second requirement; the Petitioner there argues that California has adopted a form of unconscionablity that is selectively applied to bilateral arbitration clauses. While that element is present here, the focus of this case is on the requirement that for state law to deny enforcement to an arbitration clause it must constitute a ground for "revocation." Careful analysis of the text, structure and history of Section 2 and of the FAA as a whole, establishes that ground for "revocation" is a term of art for defects in the formation of the agreement itself. In other words, the FAA limits state courts to an inquiry into the making

of the agreement to arbitrate, encompassing contract law doctrines such as fraud and duress. What the FAA denies states is the right to set their own public policy up as a bar to arbitration or particular forms of arbitration. Indeed, the purpose of the FAA was to preclude state courts from ignoring arbitration agreements based upon judicial notions of public policy.

The second requirement of Section 2 is that the state law at issue be applicable to "any contract." Thus, doctrines specific to arbitration contracts or clauses are forbidden by Section 2. *See Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). This prohibition includes the manipulation of generally applicable contract defenses in a manner that disfavors arbitration. *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 167 (5th Cir. 2004). Both *Concepcion* and this case present violations of the "any contract" requirement, because both California and New Jersey courts have applied the doctrine of unconscionability in a manner that disfavors bilateral arbitration clauses.

2. New Jersey Has A Separate, Different Unconscionability Standard For Arbitration.

In New Jersey, as in most states, a court may relieve a party from an unconscionable contract. *Sitogum Holdings, Inc. v. Ropes*, 800 A.2d 915, 918 (N.J. Super. Ct. 2002). To be unconscionable under New Jersey law, a contract must possess elements of both procedural unconscionability, which examines "the formation of the contract," and substantive unconscionability, which requires "excessively disproportionate terms" or "the exchange of obligations so one-sided as to shock the

court's conscience." *Id.* at 920-21. New Jersey courts "generally have applied a sliding-scale approach to determine overall unconscionability, considering the relative levels of both procedural and substantive unconscionability." *Delta Funding Corp. v. Harris*, 912 A.2d 104, 111 (N.J. 2006). Like other contract defenses, "the burden of proving unconscionability is on the party asserting it." *B&S Ltd. v. Elephant & Castle Int'l., Inc.*, 906 A.2d 511, 521 (N.J. Super. Ct. 2006).

Following the lead of California courts, New Jersey courts have developed a separate, different unconscionability doctrine for consumer arbitration agreements. *See Muhammad*, 912 A.2d at 96-103 (relying on *Discover Bank*). Instead of examining all the circumstances surrounding the formation of a contract to determine if the party had a meaningful choice—*as they do outside of the arbitration context, see Stelluti v. Casapenn Enterprises*, 2010 WL 3033884, at *6 (N.J. Aug. 5, 2010)—New Jersey courts automatically find procedural unconscionability when an arbitration agreement is in a standard-form contract. *Muhammad*, 912 A.2d at 96. And instead of limiting the analysis to the contract terms as they relate to the parties—*as they do outside the arbitration context, see Howard v. Diolosa*, 574 A.2d 995, 999-1000 (N.J. Super. Ct. 1990)—New Jersey courts deem provisions in a consumer arbitration agreement substantively unconscionable for "public policy" reasons wholly unrelated to the parties to the arbitration agreement at issue. *Muhammad*, 912 A.2d at 96-97. Applying a different theory of unconscionability developed just for arbitration contracts, New Jersey courts will invalidate consumer arbitration agreements when the disputes involve low-

dollar amounts, on the assumption that requiring bilateral arbitration will operate as an unlawful "exculpatory clause." *Id.* at 99.

3. Verizon Wireless's Arbitration Provision.

Keith Litman and Robert Wachtel ("Respondents"), Verizon Wireless customers since at least 2004, concede that the Customer Agreements ("Agreements") between them and Verizon Wireless have always included an arbitration provision. Compl. ¶ 9. Respondents' Agreements require the parties "TO SETTLE DISPUTES . . . ONLY BY ARBITRATION" and provide that "THE FEDERAL ARBITRATION ACT APPLIES TO TH[E] AGREEMENT." Joint Appendix on Appeal, Vol II, at A54. The arbitration provisions further provide that "ANY CONTROVERSY OR CLAIM ARISING OUT OF OR RELATING TO TH[E] AGREEMENT, OR ANY PRIOR AGREEMENT FOR WIRELESS SERVICE WITH [VERIZON WIRELESS] OR ANY OF [ITS] AFFILIATES OR PREDECESSORS IN INTEREST, OR ANY PRODUCT OR SERVICE PROVIDED UNDER OR IN CONNECTION WITH THIS AGREEMENT OR SUCH A PRIOR AGREEMENT" will be subject to arbitration. *Id.* There is no dispute that the arbitration clauses apply to all of the claims Respondents attempted to bring in federal court.

The arbitration provisions preclude class arbitration: "THIS AGREEMENT DOESN'T PERMIT CLASS ARBITRATIONS EVEN IF TH[E] PROCEDURES [OF THE AAA OR BBB] WOULD." *Id.* However, "IF FOR SOME REASON THE

PROHIBITION ON CLASS ARBITRATIONS . . . IS DEEMED UNENFORCEABLE, THEN THE AGREEMENT TO ARBITRATE WILL NOT APPLY." *Id.* at A55. Thus, arbitration must be on an individual basis. *Id.* at A54.

4. The Proceedings Below.

In October 2007, Respondents filed a putative class-action lawsuit against Verizon Wireless in the United States District Court for the District of New Jersey. App. 9a. Respondents alleged that Verizon Wireless unlawfully imposed an administrative charge. App. 9a. Verizon Wireless filed a motion to compel individual arbitration in accordance with Respondents' Agreements. App. 8a-9a. Respondents opposed the motion, contending that the arbitration agreements were unconscionable under *Muhammad*. App. 11a. The parties agreed that the only question for the district court was whether *Muhammad* is preempted by the FAA. App. 11a, 18a.

The district court granted Verizon Wireless's motion to compel. App. 28a. In doing so, it relied on the Third Circuit's opinion in *Gay v. CreditInform*, 511 F.3d 369, 394-95 (3d Cir. 2007), which held that the FAA preempted two Pennsylvania court decisions that had held arbitration clauses unconscionable because they required individual arbitration of low-dollar contract claims. *See Thibodeau v. Comcast Corp.*, 912 A.2d 874 (Pa. Super. Ct. 2006); *Lytle v. CitiFinancial Servs., Inc.*, 810 A.2d 643 (Pa. Super. Ct. 2002). The court in *Gay* refused to apply those decisions because they found arbitration provisions unconscionable "because [they were] agreement[s] to arbitrate" and not, as required

by the FAA, for a reason applicable to "*any* contract." 511 F.3d at 394-95. Finding *Gay* indistinguishable, the district court concluded that the FAA preempted *Muhammad* and ordered the parties to proceed to arbitration. App. 3a.

The Third Circuit reversed, relying on *Homa v. American Express Co.*, 558 F.3d 225 (3d Cir. 2009), a decision issued after the district court's decision in this case. App. 7a. In *Homa*, the Third Circuit distinguished *Gay*, holding that the FAA did not preempt *Muhammad*. *Homa*, 558 F.3d at 230. The *Homa* court concluded that *Muhammad* did not evince hostility toward arbitration clauses, but instead applied generally applicable state contract law, and thus did not conflict with the FAA. *Id.* Finding *Homa* "directly on point and binding" on the panel, the Third Circuit reversed and remanded. App. 7a. Shortly thereafter, this Court granted certiorari in *Concepcion*. 130 S. Ct. 3322 (2010). In light of Verizon Wireless's argument that the question presented in *Concepcion* will directly impact this case, on July 7, 2010, the Third Circuit entered a stay of the mandate in this case pending the filing of a petition for a writ of certiorari. Order, *Litman v. Cellco P'ship*, No. 08-4103 (July 7, 2010).

REASONS FOR GRANTING THE PETITION

I. As The Court's Recent Grant Of Certiorari In *Concepcion* Demonstrates, This Case Satisfies The Rule 10 Standard For Granting Certiorari.

This case presents an important and recurring question of federal law: whether the FAA preempts States from conditioning the enforcement of an arbitration agreement on the availability of class-wide arbitration. The importance of this question is indisputable—the Court examined this very issue over 25 years ago, and since then, consumer arbitration agreements have become increasingly prevalent. The Court recently confirmed the importance of this question when it granted certiorari in *Concepcion*. Because *Concepcion* is identical to this case in all material respects, the Court's grant of certiorari there demonstrates that this petition meets Rule 10's standard for granting review. Moreover, this case warrants the Court's review in its own right because Verizon Wireless advances an additional theory of preemption under the FAA that is not the focus of *Concepcion*.

In both this case and *Concepcion*, consumer-plaintiffs brought a putative class-action lawsuit under state law alleging that a wireless carrier had imposed unlawful fee increases. The wireless carrier in each case moved to compel bilateral arbitration by enforcing class-arbitration waivers. And, in both cases, the consumer-plaintiffs argued that the class-arbitration waivers were unconscionable and unenforceable pursuant to applicable state-court decisions. *Compare Litman*, 2010 WL 2017665, at *2-3 (citing *Muhammad*, 912 A.2d 88), *with Laster v. AT&T Mobility LLC*, 584 F.3d 849, 854

(9th Cir. 2009) (citing *Discover Bank*, 113 P.3d 1100). Moreover, the applicable state-court decisions—*Muhammad* and *Discover Bank*—both held that a class-arbitration waiver in a standard-form retail contract was an unconscionable "exculpatory clause" that violates "public policy" in the context of "low-value" consumer claims. *Muhammad*, 912 A.2d at 99-100; *Discover Bank*, 113 P.3d at 1108-09. Indeed, *Muhammad* is derivative of *Discover Bank*, having relied on it in reaching the conclusion that class-arbitration waivers are unconscionable. *See, e.g.*, *Muhammad*, 912 A.2d at 99 (citing *Discover Bank*, 113 P.3d at 1110).

As a result, the ultimate question to be resolved both here and in *Concepcion* is whether the FAA preempts those state-court decisions. The Ninth Circuit in *Concepcion* held that the FAA did not preempt *Discover Bank*. *See Laster*, 584 F.3d at 857-58. The Third Circuit reached the same conclusion with respect to *Muhammad*. *See Litman*, 2010 WL 2017665, at *1-2.

Even setting aside the grant of certiorari in *Concepcion*, the importance of this case is obvious. The FAA was intended to benefit both consumers and businesses by promoting arbitration as a streamlined, cost-efficient alternative to litigation. *Allied-Bruce*, 513 U.S. at 280. Class arbitration, however, fundamentally alters the nature and character of arbitration. *See Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1776 (2010) (highlighting "the fundamental changes brought about by the shift from bilateral arbitration to class-action arbitration"). In fact, class arbitration is so cumbersome that wireless carriers often include provisions that render the entire arbitration clause inapplicable if class arbitration is imposed as a matter of state law. *See* Amicus Brief of CTIA, *supra*, at 17-18.

If allowed to stand, the Third Circuit's decision will deprive consumers and businesses of the many benefits of bilateral arbitration. Together, the Third and Ninth Circuit decisions will sharply curtail the availability of arbitration on a nationwide basis—an outcome contrary to the federal policy favoring arbitration. *Moses H. Cone*, 460 U.S. at 24. Indeed, the preemption question presented in this case has the potential to affect literally hundreds of millions of arbitration agreements and thus hundreds of millions of parties thereto (both consumers and businesses).

Finally, and perhaps most importantly, certiorari should be granted because this case involves an additional theory of FAA preemption that is not the focus of *Concepcion*, a theory that could potentially dispose of both cases. *See infra* Part IIA. The argument provides an independent basis on which the Court may conclude that the FAA preempts the application of state public policy to invalidate class-arbitration waivers. Consideration of this alternative theory—rooted in the text, structure, and history of the FAA—is critical to a clear and lasting resolution of the question presented here and in *Concepcion*.[1]

1. If the Court grants review in this case, it could consider and decide the case together with *Concepcion* even though the two cases would not be heard together. The Court resolved the "honest services" cases in this manner last Term. *See Skilling v. United States*, 130 S. Ct. 2896, 2912 n.9 (2010) (noting that the Court "granted certiorari and heard arguments this Term in . . . *Black v. United States*, No. 08-876 [and] *Weyhrauch v. United States*, No. 08-1196 . . . and vacate[d] and remand[ed] those decisions in light of [*Skilling*]").

II. Review Of This Case Is Warranted Because The Decision Below Conflicts With The FAA And This Court's Precedent.

By its terms, Section 2 of the FAA displaces otherwise applicable law, making arbitration agreements "valid, irrevocable, and enforceable," as a matter of federal law, "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. "In enacting § 2 of the federal Act, Congress . . . withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland*, 465 U.S. at 10. It is thus "well-established" that Section 2 is a preemption statute. *Preston*, 552 U.S. at 353.

Under Section 2, state law is preempted unless it is a ground "for the revocation of any contract." To avoid the preemptive sweep of Section 2, state law must be both a ground for *revocation* and applicable to *any contract*. The New Jersey Supreme Court's decision in *Muhammad* runs afoul of both of these requirements. It does not rest on a recognized ground for the "revocation" of a contract as that term is used in Section 2, and it does not apply a rule of law that is applicable to "any contract."

A. Section 2 Preempts State Law That Does Not Relate To "The Making Of The Agreement To Arbitrate," Including Substantive Unconscionability.

As this Court has noted many times, Section 2 is the cornerstone of the FAA. It declares, as a matter of

federal law, that agreements to arbitrate are "valid, irrevocable, and enforceable." This declaration was meant to preclude courts from refusing to enforce otherwise valid arbitration agreements. At the same time, Section 2 includes a "savings clause" that allows for the operation of some, but not all, state contract law doctrines on arbitration clauses. The savings clause authorizes courts to refuse enforcement of arbitration agreements upon "grounds as exist in law or equity for the revocation of any contract." Properly interpreted, "grounds" for "revocation" do not include substantive unconscionability.

Congress's use of the single term "revocation" in the savings clause was critical. Unlike invalidity or unenforceability, revocation was understood to refer exclusively to defects in the formation of the contract. Thus, procedural defects, such as fraud or duress, were preserved as defenses to arbitration agreements under Section 2, but substantive attacks on arbitration clauses, under doctrines such as unconscionability or public policy were excluded from the savings clause. Indeed, application of these doctrines of invalidity and unenforceability to arbitration agreements is exactly what the FAA was enacted to stop.

This reading of the term "revocation" in Section 2 is confirmed by looking to the judicial enforcement provisions of the FAA, Sections 3 and 4. Sections 3 and 4 of the FAA provide the mechanism to obtain judicial enforcement of Section 2. Section 4, in particular, outlines a procedure for a "party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration" to petition a

federal district court to compel arbitration. 9 U.S.C. § 4. Consistent with Section 2's proclamation that all arbitration agreements are "valid, irrevocable, and enforceable" as a matter of federal law, Section 4 mandates that a court considering such a petition must compel arbitration. *Id.* ("[T]he court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement."). The only condition on this statutory mandate is that the court must be "satisfied that the *making of the agreement* for arbitration . . . is not in issue." *Id.* (emphasis added).

Thus, the language of Section 2—when read together with Section 4—"indicates that Congress created an exception to the general rule (that an arbitration clause will be enforced by its terms) only when there is a flaw in the formation of the agreement to arbitrate." *Nat'l R.R. Passenger Corp. v. Consol. Rail Corp.*, 892 F.2d 1066, 1070 (D.C. Cir. 1990); *Dean Witter Reynolds*, 470 U.S. at 218 (reading together Sections 2, 3, and 4 and concluding that a court "*shall direct* the parties to proceed to arbitration . . . absent a ground for revocation of the contractual agreement"); *see also Supak & Sons Mfr. Co. v. Pervel Indus.*, 593 F.2d 135, 137 (4th Cir. 1979) ("[Although] it does not displace state law on the general principles governing formation of the contract itself . . . § 2 is preemptive of conflicting state laws which restrict the validity or enforceability of arbitration agreements.").

Grounds for revoking an arbitration agreement thus include only defects such as fraud, duress, unequal bargaining power, and lack of capacity. *See Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04

(1967) (finding that a court properly could consider a Section 2 claim that an "arbitration clause itself" was procured by a procedural defect such as fraud, since fraud involves "an issue which goes to the 'making' of the agreement[ ] to arbitrate"); *see also Erie, Bernhardt, and Section 2 of the United States Arbitration Act: A Farrago of Rights, Remedies, and a Right to a Remedy*, 69 Yale L. J. 847, 860-61 (1960) ("[I]ssues involving the 'making' of the arbitration agreement, which the federal act declares are issues for the court, . . . would [include] fraud in the inducement of the arbitration agreement, waiver of that agreement, and . . . lack of legal capacity to agree to arbitrate." (citations omitted))

Section 2, however, does not permit inquiry into the substantive fairness of the terms of the agreement; nor does it allow a more expansive inquiry into whether the procedures for arbitration further public policy goals. *See Nat'l R.R. Passenger Corp.*, 892 F.2d at 1070 ("[A] public policy issue that may preclude enforcement of [an arbitration clause] is not such a 'ground[ ] as exist[s] at law or in equity for the revocation of any contract' within the meaning of [Section] 2." (quoting 9 U.S.C. § 2)). As this Court has explained, "[a]bsent a well-founded claim that an arbitration agreement resulted from the *sort of fraud or excessive economic power that 'would provide grounds for the revocation of any contract,'* the Arbitration Act 'provides no basis for disfavoring agreements to arbitrate statutory claims by skewing the otherwise hospitable inquiry into arbitrability.'" *Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985)) (emphasis added); *see also Gilmer v. Interstate/Johnson*

Lane Corp, 500 U.S. 20, 33 (1991); *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 483-84 (1989).

Interpreting Section 2's savings clause in this manner is consistent with the common understanding of "revocation" at the time of the FAA's enactment. At that time, the term "revocability" had two meanings. In the context of arbitration agreements, "revocability" referred to a contracting party's ability to repudiate such an agreement at will. Wesley A. Sturges, *A Treatise on Commercial Arbitrations and Awards* § 15, at 45 (1930). In particular, a party to an arbitration agreement was permitted (1) to proceed with a contract action in court despite an arbitration provision to the contrary; or, equivalently, (2) to "terminate the powers of the other party" under an arbitration provision. *Id.* Thus, an agreement to arbitrate was "revocable" by one of the parties at will "precisely" because "a contract to arbitrate [was] at issue." *Doctor's Assocs.*, 517 U.S. at 685.

Outside the arbitration context, "revocability" referred to the more limited ability of a party to nullify a contract based on formation defects. In fact, some pre-FAA decisions criticized the special rule of "revocability" in the arbitration context and argued that arbitration agreements should be revocable only for the typical reasons applicable to any contract:

> An agreement [to arbitrate] induced by fraud, or overreaching, or entered into unadvisedly through ignorance, folly or undue pressure, might well be . . . disregarded . . . . But when the parties stand upon an equal footing, and intelligently and deliberately . . . provide for

> an amicable adjustment of any difference that may arise, either by arbitration, or otherwise, it is not easy to assign at this day any good reason why the contract should not stand . . . .

Sturges § 15, at 47 (quoting *Del. & H. Canal Co. v. Pa. Coal Co.*, 50 N.Y. 250, 258 (1872)). The New York Court of Appeals made clear that, "[w]ere the question *res nova*, . . . a party would not now be permitted, *in the absence of fraud or some peculiar circumstances entitling him to relief*, to repudiate his agreement to submit to arbitration . . . ." *Del. & H. Canal*, 50 N.Y. at 258 (emphasis added); *see also Henry v. Lehigh Valley Coal Co.*, 64 A. 635, 636 (Pa. 1906).

In declaring arbitration agreements irrevocable but still subjecting them to challenges based on "grounds . . . for the revocation of any contract," Congress thus discarded the arbitration-specific concept of revocability but preserved the traditional, neutral form of revocability. *See Zimmerman v. Cohen*, 236 N.Y. 15, 20 (1923) ("The word 'irrevocable,' . . . means that the [arbitration agreement] cannot be revoked at the will of one party to it, but can only be set aside for facts existing at or before the time of its making which would move a court of law or equity to revoke any other contract."); Moses H. Grossman, *Trade Security Under Arbitration Laws*, 35 Yale L.J. 308, 319 (1926) (same); Julius Henry Cohen, *The Law of Commercial Arbitration and the New York Statute*, 31 Yale L.J. 147, 149 (1921) ("The statute does not merely validate and make enforceable and irrevocable agreements for arbitration. The act recognizes that the infirmities, common to all contracts, which furnish ground for

revocation at law or in equity, may still exist in cases of arbitration agreements.").[2] "Thus, generally speaking, if in a[n] . . . action to compel arbitration an issue of fraud, duress or misrepresentation is raised, the courts, before determining whether the parties are to proceed to arbitration, must first decide that issue." *The Arbitrable Issue: The Problem of Fraud*, 28 Fordham L. Rev. 802, 802 (1960) (citation omitted).

Just as case law and scholarship from this era confirm that Congress rejected the arbitration-specific form of revocability, they also confirm that the terms "valid" and "enforceable" in Section 2 meant something different from "irrevocable." Under the rubric of public policy—most notably, public policy against ouster of the judicial process—pre-FAA courts often held arbitration agreements invalid or otherwise "refused to enforce arbitration agreements specifically." *See* Arbitration of Interstate Commercial Disputes: Joint Hearings Before the Subcomms. on the Judiciary, 68th Cong. 38 (1924) ("*1924 Hearings*"). By declaring arbitration agreements "valid" as a matter of federal law, Congress ensured that arbitration agreements would be formally recognized by the courts. *See id.*; *Erie*, *supra*, at 854. And by

2. As this Court has acknowledged, the New York courts' analysis of the New York Arbitration Act has special relevance because the FAA was based upon the New York act, *see Allied-Bruce*, 513 U.S. at 287 (noting that "the FAA was copied" from the New York act), and "embodies practically all of the important provisions of the New York prototype of modern state arbitration statutes." Harry Baum & Leon Pressman, *The Enforcement of Commercial Arbitration Agreements in the Federal Courts*, 8 N.Y.U.L.Q. Rev. 238, 251 (1930) (citations omitted).

proclaiming arbitration agreements "enforceable," Congress ensured that arbitration agreements would be entitled to specific performance. *See 1924 Hearings*, *supra*, at 38; *Erie*, *supra*, at 856; *The New Federal Arbitration Law*, 12 Va. L. Rev. 265, 276-78 (1926).

The distinct meanings of "revocability," "invalidity," and "unenforceability" at the time Congress enacted the FAA further support this textually-rooted reading of the savings clause in Section 2. Congress declared arbitration agreements "valid" and "enforceable" in Section 2 to eliminate non-formation doctrines that denied enforcement to arbitration clauses based on judicial notions of fairness or state public policy. Congress declared them "irrevocable" to eliminate the special rules of revocation applied to arbitration agreements. Viewed in this light, grounds for "revocation" in Section 2's savings clause can only refer to traditional formation defects—for any broader meaning would have the exception swallowing the rule. *See AT&T Co. v. Cent. Office Tel., Inc.*, 524 U.S. 214, 228 (1998).

Construing "revocation" to refer only to formation defects vindicates the FAA's "basic precept that arbitration is a matter of consent, not coercion." *Stolt-Nielsen*, 130 S. Ct. at 1773 (internal quotation omitted). This limitation prevents States, such as California in *Discover Bank* and New Jersey in *Muhammad*, from invoking state public policy or their own sense of fairness to force parties to arbitrate on terms or use procedures not agreed to. *See Volt Info. Scis., Inc. v. Bd. Of Trs*, 489 U.S. 468, 479 (1989) ("[P]arties are generally free to structure their arbitration agreements as they see

fit. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted." (internal citation omitted)). At the same time, the States have the power to ensure that, as in any contract, there has been true consent in the formation of the agreement to arbitrate.

Under this construction of Section 2, resolution of the question presented here and in *Concepcion* is straightforward. Under *Muhammad* and *Discover Bank*, bilateral arbitration agreements are "unenforceable" because they are substantively unconscionable. *See Muhammad*, 912 A.2d at 98-102; *Discover Bank*, 113 P.3d at 1103. As explained above, in New Jersey (and California) whether a consumer arbitration agreement is substantively unconscionable turns on concepts of fairness and notions of public policy, not whether there are defects in formation. *See Muhammad*, 912 A.2d at 98-99, 101-02; *Discover Bank*, 113 P.3d at 1103. Because substantive unconscionability is not a "ground[]" for "revocation" under Section 2, *Muhammad* (and likewise *Discover Bank*) is preempted by Section 2.

B. Section 2 Preempts New Jersey From Manipulating Its Unconscionability Doctrine To Disfavor Arbitration Agreements.

1. The FAA Prevents States from Applying Laws or Doctrines that Uniquely Disfavor Arbitration.

Under the FAA, arbitration agreements are valid, irrevocable, and enforceable as a matter of federal law, "save upon such grounds as exist at law or in equity for

the revocation of *any contract*." 9 U.S.C. § 2 (emphasis added). Section 2 thus prevents states from adopting novel laws or rules that apply only to arbitration agreements. "A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the text of Section 2]." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987); *see Oblix, Inc. v. Winiecki*, 374 F.3d 488, 492 (7th Cir. 2004) ("[N]o state can apply to arbitration (when governed by the Federal Arbitration Act) any novel rule.").

Nor can states mask this discrimination by pretending to apply a generally applicable contract defense. If the defense "singl[es] out arbitration provisions for suspect status," *Doctor's Assocs.*, 517 U.S. at 687, it is preempted by the FAA, regardless of the label used by the state court. "That a state decision employs a general principle of contract law, such as unconscionability, is not always sufficient to ensure that the state law rule is valid under the FAA." *Iberia Credit Bureau*, 379 F.3d at 167. "[S]tate courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to special scrutiny." *Id.* Section 2 thus embodies a "principle of rigorous equality"—"antagonism toward arbitration . . . howsoever manifested in state law, is preempted." *Secs. Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1119-20 (1st Cir. 1989).

2. New Jersey Courts Distort Unconscionability Law to Disfavor Arbitration Agreements.

There are two required elements of unconscionability in New Jersey: procedural unconscionability, which examines "the formation of the contract," and substantive unconscionability, which looks for "excessively disproportionate terms" or "the exchange of obligations so one-sided as to shock the court's conscience." *Sitogum Holdings*, 800 A.2d at 921. Like the California courts, New Jersey courts manipulate both of these factors to disfavor arbitration agreements. *Compare Muhammad*, 912 A.2d at 96-97, *with Discover Bank*, 113 P.3d at 1108. Instead of examining all the circumstances surrounding the formation of the contract, New Jersey courts automatically find procedural unconscionability when a consumer arbitration agreement is contained in an "adhesion contract." *See Muhammad*, 912 A.2d at 97. And instead of focusing on the contract terms as they relate to the individual parties, the courts determine substantive unconscionability by examining broad public policy concerns. *See id.* at 98-99, 101-02. The FAA preempts exactly this type of manipulation. *See Doctor's Assocs.*, 517 U.S. at 687.

New Jersey courts generally determine procedural unconscionability by focusing on formation defects, examining "a variety of inadequacies, such as age, literacy, lack of sophistication, hidden or unduly complex contract terms, bargaining tactics, and the particular setting existing during the contract formation process." *Sitogum Holdings*, 800 A.2d at 920-22. In particular,

courts examine whether there was an "absence of meaningful choice" when the contract was formed. *Id.* at 920 (quotation omitted). Whether a meaningful choice exists "can only be determined by consideration of all the circumstances surrounding the transaction." *Abel Holding Co. v. Am. Dist. Tel. Co.*, 350 A.2d 292, 304 (N.J. Super. Ct. 1975) (citation omitted).

Thus, in the non-arbitration context, New Jersey courts generally decline to find procedural unconscionability when the party had meaningful commercial alternatives. For example, in *Stelluti*, the New Jersey Supreme Court examined whether a standardized contract containing an exculpatory clause releasing a fitness center from liability was unconscionable. Although the consumer had signed a "standard pre-printed form presented . . . on a typical 'take-it-or-leave-it basis,'" was a layperson with no specialized knowledge, and presumably received no explanation on the legal effect of releasing the fitness center from liability, the Court found no procedural unconscionability. *Stelluti*, 2010 WL 3033884, at *6. Stelluti "could have taken her business to another fitness club, could have found another means of exercise aside from joining a private gym, or could have thought about it and even sought advice before signing up and using the facility's equipment." *Id.* Thus, "although the terms of the agreement were presented 'as is' to Stelluti," the court found that "the agreement was not void based on any notion of procedural unconscionability." *Id.*

But in the arbitration context, New Jersey courts undertake a completely different analysis. Following

California's lead, New Jersey courts automatically find procedural unconscionability when a consumer arbitration agreement is in a standardized contract. *See Muhammad*, 912 A.2d at 96 ("[A]dhesion agreements necessarily involve indicia of procedural unconscionability."); *Discover Bank*, 113 P.3d at 1108. For example, in *Estate of Ruszala v. Brookdale Living Communities, Inc.*, the court examined whether arbitration agreements with an assisted living facility were unconscionable. 2010 WL 3118695, at *1 (N.J. Super. Ct. App. Div. Aug. 10, 2010). The court noted "the absence of evidence showing procedural unconscionability," such as how the contracts were formed or the parties' level of education and sophistication in legal matters. *Id.* at *12. Nevertheless, the court was "satisfied that the residency agreements [were] contracts of adhesion" and were therefore procedurally unconscionable. *Id.* at *12-13. In short, the court applied a different, less-demanding procedural unconscionability standard than it employs outside the arbitration context.

New Jersey courts also distort substantive unconscionability law to disfavor consumer arbitration agreements. At its base, substantive unconscionability examines only the contract terms as they relate to the individual parties to the contract at the time of contracting. *See Howard*, 574 A.2d at 999-1000 (requiring "such patent unfairness in the contract that no reasonable person not acting under compulsion or out of necessity would accept its terms"); *see also Reibold v. Simon Aerials, Inc.*, 859 F. Supp. 193, 199 (E.D. Va. 1994) ("[W]hether any agreement is unconscionable or not can only be examined with

reference to the original parties to the bargain."). In contrast, the invocation of judicial notions of public policy as a basis for disregarding a contract term places the focus not on the parties to the contract but on the interests of third parties outside of the contract, e.g., the general population. *See Vasquez v. Glassboro Serv. Ass'n, Inc.*, 415 A.2d 1156, 1162-68 (N.J. 1980) ("[C]ourts in New Jersey have refused to enforce contracts that violate the public policy of the State. . . . Contracts have been declared invalid because they violate statutes, promote crime, interfere with the administration of justice, encourage divorce, violate public morality, or restrain trade." (citations omitted)).

Thus, public policy is not part of the substantive unconscionability analysis, at least outside of the arbitration context. *See, e.g., Stelluti*, 2010 WL 3033884, at *7-13 (finding no unconscionability and separately analyzing "whether enforcement of an exculpatory agreement would be contrary to public policy"); *Marcinczyk v. State of N.J. Police Training Comm'n*, 968 A.2d 1205, 1210 (N.J. Super. Ct. App. Div.) (examining separately whether an exculpatory agreement is unenforceable because it "(1) negatively impacts the public interest . . . or (3) is unconscionable"), *cert. granted*, 200 N.J. 370 (2009).

But in the consumer arbitration context, New Jersey courts shoe-horn broad conceptions of public policy into substantive unconscionability. Indeed, after *Muhammad*, bilateral arbitration agreements are substantively unconscionable because they violate a New Jersey public policy favoring the incidents of a judicial class action. 912 A.2d at 99, 102 (explaining that the "most

important" factor was "the *public interest[]* affected by the contract" and that the court's unconscionability finding was "rooted in [a] fact-sensitive *public interest* assessment") (emphasis added); *see Estate of Ruszala*, 2010 WL 3118695, at *15 (expressly declining to limit its unconscionability analysis to the rights and duties of the parties to the arbitration agreement and instead employing a "broader inquiry into how the identified restrictions affect our State's public policy of protecting a vulnerable and discrete class of consumers").

In particular, the *Muhammad* court focused on the allegedly exculpatory nature of the class-action waiver. That is, *Muhammad* focused on the effect of the class action waiver on *third parties* and general corporate fraud enforcement as opposed to the rights and duties of the parties to the particular contract. *Muhammad*, 912 A.2d at 96-97. Accordingly, substantive unconscionability as applied in *Muhammad* is not a "generally applicable contract defense"—it is the enforcement of a "public policy" that disfavors individual arbitration.[3]

By inserting their public policy concerns directed at bilateral arbitration into the doctrine of substantive unconscionability, New Jersey courts attempt to mask their anti-arbitration animus. But even a cursory

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3. Moreover, the "exculpatory clause" rationale ignores the fact that state attorneys general, *see, e.g.*, N.J.S.A. 56:8-1 *et seq.* (authorizing the New Jersey Attorney General to enforce state consumer protection law), and appropriate federal agencies have oversight over sellers of consumer products. *Cf. Gilmer*, 500 U.S. at 32 ("[I]t should be remembered that arbitration agreements will not preclude the EEOC from bringing actions seeking class-wide and equitable relief.").

comparison of arbitration and non-arbitration cases reveals stark differences in analysis and result. *Compare Muhammad*, 912 A.2d at 98-99 (refusing to enforce an arbitration provision in a standardized contract because "public policy" prohibits a class-arbitration waiver from "effectively" functioning as an "exculpatory clause"), *with Stelutti*, 2010 WL 3033884, at *7, *10-12 (enforcing an express exculpatory clause in a standardized contract and noting that the "avoidance of a flood of litigation" could be an "important public polic[y]" (internal quotation marks and alterations omitted)). This "kind of value judgment is foreclosed precisely because the FAA ordains that the state's appulse toward arbitration agreements must be the same as its approach to contracts generally." *Secs. Indus. Ass'n*, 883 F.2d at 1121. What matters is not the legal label placed on the doctrine, but the manner in which the doctrine has been employed. Were the law otherwise, States would be free to thwart arbitration at will by simply invalidating any disfavored arbitration provision as substantively unconscionable. *Iberia Credit Bureau*, 379 F.3d at 167 ("[S]tate courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to special scrutiny.").

Muhammad also violates the FAA by singling out a particular class of contracts for which bilateral arbitration is forbidden. By holding that a class-arbitration waiver in any consumer contract in a case involving a "low-value" dispute is substantively unconscionable, *see Delta Funding*, 912 A.2d at 115, the New Jersey Supreme Court has rendered an entire class of arbitration agreements unconscionable under New Jersey law. This is flatly forbidden under the FAA. *See*

Saturn Distribution Corp. v. Williams, 905 F.2d 719, 726 (4th Cir. 1990) ("The FAA does not permit a state to single out arbitration agreements in standardized contracts and, in effect, declare their very formation to be unconscionable."). Only Congress—not the courts—may "identify any category of claims as to which agreements to arbitrate will be held unenforceable." *Mitsubishi Motors*, 473 U.S. at 627.

C. *Muhammad* Conflicts With The Policies Underlying the FAA.

In addition to conflicting with the plain language of Section 2, *Muhammad* also conflicts with the policies embodied in the FAA. Congress enacted the FAA "to ensure that private agreements to arbitrate are enforced according to their terms," *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 52 (1995), and to "revers[e] centuries of judicial hostility to arbitration agreements," *Scherk*, 417 U.S. at 510. The Court has explained that "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone*, 460 U.S. at 24. Because refusal to enforce a class-arbitration waiver conflicts with these policies, *Muhammad* is preempted. *See Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 873 (2000).

"[T]he central or primary purpose of the FAA is to ensure that private agreements to arbitrate are enforced according to their terms." *Stolt-Nielsen*, 130 S. Ct. at 1773 (internal quotation marks omitted). This includes terms dictating the "procedure" for arbitration.

Hall Street Assocs., LLC v. Mattel, Inc., 552 U.S. 576, 586 (2008); *see also* 9 U.S.C. § 4 ("A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court . . . for an order directing that such arbitration proceed *in the manner provided for in such agreement*." (emphasis added)). In other words, the FAA ensures that "arbitration is a matter of consent, not coercion." *Stolt-Nielsen*, 130 S. Ct. at 1773 (internal quotation marks omitted).

The Court recently made clear that there is no policy imperative to ignore the terms of an arbitration agreement and insist on the availability of class procedures. In *Stolt-Nielsen*, the Court held that "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so." 130 S. Ct. at 1775 (emphasis in original). Both "courts and arbitrators," the Court emphasized, "must not lose sight of" their task "to give effect to the intent of the parties." *Id.* They "'ha[ve] no general charter to administer justice for a community which transcends the parties.'" *Id.* (quoting *United Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 581 (1960)).

Muhammad contravenes this principle by requiring that, as a matter of state law, consumer arbitration agreements must either allow collective arbitration or face judicial nullification. *Id.* ("[P]arties are 'generally free to structure their arbitration agreements as they see fit' [and] . . . may specify with whom they choose to arbitrate their disputes."). Indeed, New Jersey is replacing the agreed-upon arbitration rules with a

process that undoubtedly will be far more complex and less expeditious than contracted for by the parties. *See Mitsubishi Motors*, 473 U.S. at 628 (explaining that this process "trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration"). In short, *Muhammad* is "fundamentally at war with the foundational FAA principle that arbitration is a matter of consent." *Stolt-Nielsen*, 130 S. Ct. at 1775. Because *Muhammad* has imposed New Jersey's idiosyncratic policy views on the contracting parties, thereby effectively rewriting lawfully formed arbitration agreements, it directly conflicts with the FAA and is preempted.

Muhammad's refusal to enforce a bilateral arbitration agreement on the basis of New Jersey public policy in favor of class procedures is precisely the sort of "judicial hostility to arbitration agreements" that the FAA was enacted to reverse. *Scherk*, 417 U.S. at 510; *see Hall Street*, 552 U.S. at 581 ("Congress enacted the FAA to replace judicial indisposition to arbitration."). If a court could simply alter the terms of an arbitration agreement, as the *Muhammad* court did, nothing would prevent it from turning an arbitration proceeding into the equivalent of a judicial proceeding complete with a jury and the Federal Rules of Evidence. Arbitration, however, is meant to be different from litigation—its primary goal is to be swifter and less expensive. *See* H.R. Rep. No. 97-542, at 13 (1982); *14 Penn Plaza LLC v. Pyett*, 129 S. Ct. 1456, 1464 (2009) ("Parties generally favor arbitration precisely because of the economics of dispute resolution."). The Court has recognized that the benefits of arbitration are lost when arbitration shifts from bilateral to class-action arbitration. *See Stolt-*

Nielsen, 130 S. Ct. at 1776. Nor could Congress have envisioned the application of class procedures to arbitration, as Federal Rule of Civil Procedure 23, which controls class action litigation, was not enacted until 1937, twelve years after the FAA.

Nevertheless, *Muhammad* held that a clause requiring bilateral arbitration was unenforceable solely because it was, in the court's view, contrary to a state public policy that favors all the incidents of a class action in a judicial forum. 912 A.2d at 97-98. *Muhammad* thus quite clearly favors the procedures of a judicial class action over bilateral arbitration. This is a prohibited basis for nullifying an arbitration agreement. *See 14 Penn Plaza*, 129 S. Ct. at 1471 ("[T]hat arbitration procedures are more streamlined than federal litigation is not a basis for finding the forum somehow inadequate.").

Under *Muhammad*, a state court could invalidate an arbitration agreement based upon its lack of any procedure that the court finds, in its view, is essential to advance some state public policy. If New Jersey can elevate the class-action form above a selected form of arbitration, Delaware might find that more formal discovery is necessary in arbitration, or Pennsylvania might find that a jury of six arbitrators must come to a unanimous "verdict" in order to render arbitration fair and consistent with state public policy. This path has no logical terminus; the correct course under the FAA is for the Court not to allow even the first step.

Finally, to allow New Jersey courts to rely on "public policy" to rewrite or nullify arbitration agreements

would directly contravene Congress's goal of precluding courts from striking down arbitration agreements based on common-law hostility toward arbitration. Congress enacted the FAA in direct response to a state public policy that permitted courts to ignore arbitration agreements. *See* Sturges, *supra*, § 15, at 45. It would be absurd to conclude that the FAA nonetheless permits the survival of state public policy that voids some or all of an arbitration agreement. Such an interpretation of the FAA would gut the statute by permitting the old judicial hostility to arbitration to reemerge under the guise of "public policy." This Court has not countenanced such backsliding. *Mitsubishi Motors*, 473 U.S. at 626-27 ("[W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.").

The FAA was enacted to ensure that arbitration agreements are enforced according to their terms and to eliminate judicial hostility toward arbitration. After *Muhammad*, however, all consumer agreements that require individual arbitration will be unenforceable in New Jersey. *Muhammad* thus frustrates the purpose of the FAA and is preempted.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for writ of certiorari.

Respectfully submitted,

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September 20, 2010

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED MAY 21, 2010

No. 08-4103

KEITH LITMAN; ROBERT WACHTEL, Individually and on behalf of all others similarly situated,

Appellants,

v.

CELLCO PARTNERSHIP d/b/a Verizon Wireless

On Appeal from the United States District Court for the District of New Jersey
(D.C. No. 07-cv-4886)
District Judge: Honorable Freda Wolfson

Before: SCIRICA, JORDAN and COWEN, *Circuit Judges*

OPINION OF THE COURT

JORDAN, *Circuit Judge.*

Appellants Keith Litman and Robert Wachtel appeal from an order of the United States District Court for the District of New Jersey compelling arbitration and dismissing their case. For the following reasons, we will vacate the District Court's order and remand for further proceedings consistent with this opinion.

Appendix A

I. Background

Litman and Wachtel brought this putative class action against Cellco Partnership d/b/a Verizon Wireless ("Verizon") based on Verizon's alleged unlawful imposition of administrative charges on class members' cell phone accounts.[1] The complaint asserts breach of contract, unjust enrichment, and violations of the New Jersey Consumer Fraud Act, N.J. Stat. Ann. § 56:8-1, *et seq.* Verizon moved to compel arbitration pursuant to an arbitration clause in the relevant customer agreements, which mandates individual arbitration of disputes. In other words, the arbitration clause prohibits class arbitrations.[2]

In response to the motion, Litman and Wachtel countered that the arbitration clause in their customer agreements was unenforceable because, pursuant to *Muhammad v. County Bank of Rehoboth Beach, Delaware*, arbitration provisions in contracts of adhesion that prohibit use of a class action mechanism for low-value claims are unconscionable under New Jersey law. 189 N.J. 1, 912 A.2d 88, 100 (N.J. 2006) ("We hold . . . that the presence of the class-arbitration waiver in

1. Specifically, Litman and Wachtel argue that, in September of 2005, Verizon imposed a bogus monthly administrative charge of forty cents on its customers and increased that charge to seventy cents in March of 2007.

2. The arbitration clause also provides that the agreement to arbitrate is inapplicable in the event that the class-arbitration provision is found to be unenforceable.

[plaintiff's] consumer arbitration agreement renders that agreement unconscionable."). Verizon agreed for purposes of the motion that *Muhammad* applies to the parties' dispute, but argued that *Muhammad* is preempted by the Federal Arbitration Act ("FAA").

The District Court, relying on our decision in *Gay v. Creditinform*, 511 F.3d 369 (3d Cir. 2007), agreed with Verizon and dismissed the case in favor of arbitration. The Court found the instant matter to be indistinguishable from *Gay*, which it understood as concluding that the FAA preempted Pennsylvania case law stating that class-arbitration waivers in contracts of adhesion are unconscionable. Litman and Wachtel timely appealed.

After the opening and answering briefs were submitted to us, another panel of our Court issued its decision in *Homa v. American Express Co.*, 558 F.3d 225 (3d Cir. 2009). As more fully described herein, the *Homa* opinion distinguished *Gay* and held that the FAA does not preempt *Muhammad*. *Id.* at 230. In the wake of *Homa*, Litman and Wachtel moved for summary reversal of the District Court's order compelling arbitration and moved to forego oral argument. Verizon opposed both motions, urging us to disregard *Homa* because it irreconcilably conflicts with *Gay*.[3] Thereafter,

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3. *Amici*, American Financial Services Association, Chamber of Commerce of the United States of America, and Consumer Bankers Association, filed a brief in support of Verizon likewise asserting that *Homa* disregarded *Gay* and therefore should itself be disregarded.

we granted Verizon's motion to stay the appeal pending our en banc decision in *Puleo v. Chase Bank,—F.3d—*, No. 08-3837, 2010 U.S. App. LEXIS 9497, 2010 WL 1838762 (3d Cir. May 10, 2010) (en banc).

II. Discussion[4]

Preliminarily, we note, as we did in *Homa*, that *Gay's* discussion of the application of the FAA to Pennsylvania law appears to be dicta. *Homa*, 558 F.3d at 229. *Homa* was admittedly ambivalent in its treatment of *Gay's* discussion of Pennsylvania law, *see id.*, 558 F.3d at 230 ("Whether dicta or not . . . ."), however, in our recently filed *Puleo* opinion, we again referred to this aspect of *Gay* as dicta, *Puleo*, 2010 U.S. App. LEXIS 9497, 2010 WL 1838762, at *3, n.2 ("[I]t is worth noting our agreement that *Gay's* discussion of Pennsylvania law was indeed dicta, since our holding in *Gay* was that Virginia law governed the parties' arbitration agreement."), which it plainly is, because *Gay* held that Virginia law, not Pennsylvania law, governed the parties' dispute. *Gay*, 511 F.3d at 390-92. Thus, the discussion of Pennsylvania case law in *Gay* was "not essential to the decision" in that case, even if it might have been

4. The District Court's jurisdiction was based on diversity of citizenship pursuant to the Class Action Fairness Act of 2005. *See* 28 U.S.C. § 1332(d). We have jurisdiction over this appeal pursuant to 9 U.S.C. § 16(a)(3). Our review of the District Court's decision to compel arbitration is plenary. *Trippe Mfg. Co. v. Niles Audio Corp.*, 401 F.3d 529, 531 (3d Cir. 2005) *(citing Bouriez v. Carnegie Mellon Univ.*, 359 F.3d 292, 294 (3d Cir. 2004)).

"briefed, and argued by counsel, and ... passed on by the court." BLACK'S LAW DICTIONARY (9th ed. 2009). As such, that portion of *Gay* is not binding on subsequent panels of this Court. *See Am. Civil Liberties Union of N.J. ex rel. Lander v. Schundler*, 168 F.3d 92, 98 n.6 (3d Cir. 1999) ("[W]e have repeatedly held that dicta are not binding.").

Thus, the panel addressing *Homa* was not bound by that portion of the *Gay* decision. Moreover — and here we may wander into dicta ourselves — we cannot conclude that *Homa* and *Gay* are irreconcilable. According to Verizon, *Gay* requires preemption of *Muhammad* because *Muhammad* is indistinguishable from *Thibodeau v. Comcast Corp.*, 2006 PA Super 346, 912 A.2d 874 (Pa. Super. Ct. 2006), one of the Pennsylvania cases *Gay* found to be preempted. *Gay*, 511 F.3d at 395 ("We, however, reject *Lytle* and *Thibodeau* for we do not agree with them as there is no escape from the fact that they deal with agreements to arbitrate, rather than with contracts in general ... ."). As Verizon sees it, *Homa's* conclusion to the contrary is therefore in conflict with *Gay*. The dicta in *Gay* interpreted Pennsylvania case law to "hold that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate," and the preemption determination that followed was based on that construction. *Gay*, 511 F.3d at 395. By contrast, in *Homa*, we read *Muhammad* to apply general principles of contract interpretation in its invalidation of the class-arbitration waiver. *Homa*, 558 F.3d at 230. *Muhammad* did not say that arbitration itself is unconscionable, but

instead held that "[a]s a matter of generally applicable state contract law, it was unconscionable for defendants to deprive [plaintiff] of the mechanism of a class-wide action, whether in arbitration or in court litigation." *Muhammad*, 912 A.2d at 100-101. Since *Muhammad* did not evince hostility toward arbitration clauses, which was the concern in *Gay*, it did not conflict with the FAA. *See Homa*, 558 F.3d at 230; *see also Puleo*, 2010 U.S. App. LEXIS 9497, 2010 WL 1838762, at *3, n.2 ("[T]he New Jersey case law at issue in *Homa* did not evince hostility toward arbitration clauses, which was the concern about Pennsylvania law expressed in *Gay*.").

We also explained in *Homa* that *Gay* could not be read as a "blanket prohibition on unconscionability challenges to class-arbitration provisions" since the FAA permits the use of generally applicable contract defenses to attack arbitration agreements. *Homa*, 558 F.3d at 230; *see* 9 U.S.C. § 2 (contractual arbitration provisions "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."). Verizon may be correct that *Muhammad* bears many similarities to *Thibodeau*, but any tension between the dicta in *Gay* and the holding in *Homa* is not beyond resolution, as we have discussed. *See International Brotherhood of Electrical Workers, Local 803 v. NLRB*, 826 F.2d 1283, 1293 n.17 (3d Cir. 1987) ("[A]s a panel of this Court, it is our duty to harmonize our decisions where it is possible to do so. Consideration of alleged inconsistencies between published opinions and the determination whether to overrule an opinion of this Court is reserved for in banc review.").

More importantly, *Homa* is prior precedent that is directly on point and binding on us. *See Garcia v. AG of the United States*, 553 F.3d 724, 727 (3d Cir. 2009) ("We are bound by precedential opinions of our Court unless they have been reversed by an en banc proceeding or have been adversely affected by an opinion of the Supreme Court."); *see also* Third Circuit Internal Operating Procedure 9.1 ("[T]he holding of a panel in a precedential opinion is binding on subsequent panels."). We are not in a position to reexamine *Homa*, and, since it controls here, we will vacate the District Court's order compelling arbitration and remand for further proceedings. [5]

III. Conclusion

Homa concluded that the FAA does not preempt *Muhammad* and, therefore, *Homa* governs the outcome of this case. Accordingly, the District Court's order compelling arbitration is vacated and the matter is remanded for further proceedings consistent with this opinion.

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5. We note that the Supreme Court's recent ruling in *Stolt-Nielson S.A. v. AnimalFeeds International Corp.*,— S. Ct.—, 2010 U.S. LEXIS 3672, 2010 WL 1655826 (Apr. 27, 2010), does not alter our analysis and conclusion. The *Stolt-Nielson* Court addressed the specific question of "whether imposing class arbitration on parties whose arbitration clauses are 'silent" on that issue is consistent with the [FAA]." 2010 U.S. LEXIS 3672, [WL] *Id.* at *4. It did not consider the distinct issues of state law preemption and unconscionability. In fact, the en banc Court in *Puleo* expressly cited *Stolt-Nielson* without then questioning whether it precluded an unconscionability determination. *See Puleo*, 2010 U.S. App. LEXIS 9497, 2010 WL 1838762, at *6 n.5.

APPENDIX B — OPINION OF THE UNITED STATES DISTRICT COURT DISTRICT OF NEW JERSEY DATED SEPTEMBER 29, 2008

Civil Action No.: 07-CV-4886(FLW)

LITMAN, *et al.*,

Plaintiffs,

v.

CELLCO PARTNERSHIP
d/b/a VERIZON WIRELESS,

Defendant.

OPINION

WOLFSON, United States District Judge:

Plaintiffs Keith Litman and Robert Wachtel (collectively "Plaintiffs"), Verizon customers since at least 2004, bring this class action lawsuit against Defendant Cellco Partnership d/b/a Verizon Wireless ("Defendant" or "Verizon") alleging Defendant improperly imposed an administrative charge on their cellular telephone accounts. In accordance with the Customer Agreements between the Plaintiffs and Verizon, which included arbitration provisions, Defendant files the current Motion to Compel

Arbitration in lieu of an Answer.[1] Plaintiffs argue that the arbitration provisions' preclusion of class arbitration should be invalidated because they are unconscionable under New Jersey law. On the other hand, Defendant claims that the Federal Arbitration Act ("FAA"), as interpreted by the Third Circuit, preempts New Jersey law. For the reasons discussed below, the Court finds that the arbitration agreement is enforceable and Defendant's Motion to Compel Arbitration is granted.

I. Factual Background and Procedural History

The Court will only recount facts relevant for the purpose of this motion. On October 9, 2007, Plaintiffs filed this suit against Verizon on behalf of other similarly situated Verizon customers claiming that they were unlawfully charged an "administrative charge" of $ 0.40 and/ or $ 0.70, as part of the monthly charges for each of their Verizon phone lines. Complaint ("Compl.") ¶ 1. Verizon provides wireless communication services to over 60 million customers and telephone lines nationally. *Id.* ¶ 8(b). Plaintiffs allege that at the time they became Verizon customers and entered into their fixed price contracts with Verizon, Verizon did not charge an administrative charge and nothing in the service agreements specifically authorized Verizon to add such a charge. *Id.* ¶ 21(a). Plaintiffs, however, allege that in

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1. Defendant simultaneously files a Motion to Dismiss Plaintiffs' claims. Having determined that the parties must arbitrate their claims, this case is dismissed, and the separate Motion to Dismiss is moot.

October 2005, Defendant unilaterally decided to assess an administrative charge to all customers and informed all customers of this change with a standard notice form. *Id.* P 21(b).

Plaintiffs have been Verizon customers since at least 2004 and concede that, prior to January 2005, Verizon used a standard customer agreement ("Agreement") with an arbitration provision. *Id.* ¶ 9.[2] The Agreement required Plaintiffs and Verizon "TO SETTLE DISPUTES (EXCEPT CERTAIN SMALL CLAIMS) ONLY BY ARBITRATION." Defendant's Motion to Compel Arbitration ("Def. Mot.") Ex. A, CA-7; D, 12 (emphasis in original). Plaintiffs allege that, in January 2005, Verizon "adhesively" modified the Agreement's arbitration provision. *Id.* ¶¶ 9, 10. The modification stated that the "THE FEDERAL ARBITRATION ACT APPLIES TO TH[E] AGREEMENT" and that the Agreement "DOESN'T PERMIT CLASS

2. Defendant claims that the November 2006 Agreement governs Litman's Verizon account and the September 2007 Agreement governs Wachtel's Verizon account. Defendant's Motion to Compel Arbitration ("Def. Mot.") Ex. A, D. While Plaintiffs state that"Defendant needlessly confuses the question of what version of Verizon's Agreements control each Plaintiff's account and when," Plaintiffs agree that their continued use of Verizon's services made the revised Agreements effective. Plaintiffs' Brief in Opposition to Defendant's Petition to Compel Arbitration ("Pl. Opp.") at 2 n. 2. Because Verizon's customer service agreements have the same language regarding arbitration, FAA applicability, and the class arbitration waiver, they are addressed as one, "the Agreement," in this Opinion.

ARBITRATION." Def. Mot. at Ex. A, CA-8; D, 12 (emphasis in original). This revised Agreement also states that "IF FOR SOME REASON THE PROHIBITION ON CLASS ARBITRATIONS . . . IS DEEMED UNENFORCEABLE, THEN THE AGREEMENT TO ARBITRATE WILL NOT APPLY." *Id.* at Ex. A, CA-9 (emphasis in original).

In accordance with the Agreement's arbitration provision, Verizon has moved to compel Plaintiffs to individually arbitrate their claims, consistent with the requirements of the Federal Arbitration Act ("FAA"). In response, Plaintiffs argue that because the New Jersey Supreme Court, in *Muhammad v. County Bank of Rehoboth Beach, Del.*, 189 N.J. 1, 912 A.2d 88 (2006), has held that an arbitration provision in a consumer contract of adhesion that precludes class arbitration of low-value claims is unconscionable under New Jersey law, similarly, the arbitration provision in their Agreement is unenforceable. On the other hand, while the parties agree that Plaintiffs may proceed with this lawsuit if *Muhammad* controls, Defendant contends that, for a number of reasons, *Muhammad* is preempted by the FAA, the class arbitration waiver is valid, and Plaintiffs must arbitrate their claims individually. This Court agrees.

II. Discussion

A. The Federal Arbitration Act ("FAA")

"[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *AT&T Tech., Inc. v. Communications Workers of Am.*, 475 U.S. 643, 648, 106 S. Ct. 1415, 89 L. Ed. 2d 648 (1986) (citations omitted); *see also Laborers' Int'l Union of N. Am. v. Foster Wheeler Corp.*, 868 F.2d 573, 576 (3d Cir. 1989) (per curiam). "The question whether the parties have submitted a particular dispute to arbitration . . . is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise." *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83, 123 S. Ct. 588, 154 L. Ed. 2d 491 (2002) (internal quotations and citations omitted); *see also Laborers' Int'l Union of N. Am.*, 868 F.2d at 576. The court does not consider the merits of the claim, but "decides only whether there was an agreement to arbitrate, and if so, whether the agreement is valid." *Great W. Mortgage Corp. v. Peacock*, 110 F.3d 222, 228 (3d Cir. 1996) (citing 9 U.S.C. § 2). If the court finds there is an agreement to arbitrate, the disposition of the merits is left to the arbitrator. *Id.* The Third Circuit has set forth a two-prong inquiry for courts to use when determining whether to compel arbitration. Under this two-prong test, the questions posed are: "(1) Did the parties seeking or resisting arbitration enter into a valid arbitration agreement? (2) Does the dispute between those parties fall within the language of the arbitration agreement?" *John Hancock*

Mut. Life Ins. Co. v. Olick, 151 F.3d 132, 137 (3d Cir. 1998) (citations omitted).

With respect to the first prong, "[f]ederal law determines whether an issue governed by the FAA is referable to arbitration." *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 178 (3d Cir. 1999). Similarly, the interpretation and construction of arbitration agreements is determined by reference to federal substantive law. *See Id.* at 179; *see also Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 25 n. 32, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983). While federal law is used to interpret such agreements, state law may be applied, pursuant to § 2 of the FAA. *Harris*, 183 F.3d at 179. Section 2 of the FAA provides that arbitration agreements are "valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The FAA was implemented "to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts." *Gay v. CreditInform*, 511 F.3d 369, 378 (3d Cir. 2007) (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24, 111 S. Ct. 1647, 114 L. Ed. 2d 26 (1991)). As such, the FAA creates a "strong presumption in favor of arbitration, and doubts 'concerning the scope of arbitrable issues should be resolved in favor of arbitration.'" *Great W. Mortg. Corp. v. Peacock*, 110 F.3d 222, 228 (3d Cir. 1997) (quoting *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24-25). Nonetheless, "generally applicable contract

defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Doctor's Assoc., Inc. v. Casarotto*, 517 U.S. 681, 687, 116 S. Ct. 1652, 134 L. Ed. 2d 902 (1996). "The party challenging a contract provision as unconscionable generally bears the burden of proving unconscionability." *Harris*, 183 F.3d at 181.

The Third Circuit has recently reaffirmed that "[t]he text of § 2 provides the touchstone for choosing between state-law principles and the principles of federal common law envisioned by the passage of the FAA: An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, 'save upon such grounds as exist at law or in equity for the revocation of *any* contract.'" *Gay*, 511 F.3d 369 at 394 (quoting *Perry v. Thomas*, 482 U.S. 483, 492 n. 9, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987)) (emphasis in original). "[S]tate law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Id.* In *Perry*, the Supreme Court found:

> A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of *§ 2*. A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court

> rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.

483 U.S. at 492 n. 9 (internal citations omitted). Confirming that the "FAA reflects a liberal federal policy favoring arbitration agreements," the Third Circuit, in addressing class action waivers in arbitration agreements, held that "whatever the benefits of class actions, the FAA *requires* piecemeal resolution when necessary to give effect to an arbitration agreement." *Gay,* 511 F.3d at 394 (internal citations and quotations omitted) (emphasis in original). Therefore, the Third Circuit has found that class action waivers in arbitration agreements are not *per se* unconscionable, but rather are valid, irrevocable, and enforceable under 9 U.S.C. § 2. Id.

The second part of the two-prong test requires the Court to determine if the dispute between the parties falls within the language of the arbitration agreement. *See John Hancock Mut. Life Ins. Co.,* 151 F.3d at 137. Because Plaintiffs do not dispute that the Agreement's arbitration provision, if valid, applies to them, the Court need not conduct an in-depth analysis of this second question.

B. The FAA Requires Enforcement of the Arbitration Agreement

Although the FAA requires enforcement of valid arbitration agreements that include class action waivers, nonetheless Plaintiffs argue that the Agreement's arbitration clause is unenforceable because its class arbitration waiver renders it unconscionable pursuant to *Muhammad*. In *Muhammad*, the New Jersey Supreme Court held that, under state law, class arbitration waivers may be unconscionable and unenforceable when they are in an arbitration agreement that is part of a consumer contract of adhesion. 189 N.J. at 6-7. Muhammad was a customer of a payday loan company who received a short-term unsecured loan. *Id.* at 7. She brought suit on behalf of herself and other consumers similarly situated claiming that the terms of the loan violated the New Jersey Consumer Fraud Act ("CFA"). *Id.* at 6. The parties' agreement included an arbitration provision requiring all disputes to be "resolved by binding individual (and not class) arbitration," and that the plaintiff "not bring, join or participate in any class action as to any claim, dispute or controversy [the plaintiff] may have." *Id.* at 8. First, the Court separated these two clauses and only examined the class arbitration clause, leaving the validity of the rest of the agreement to be determined by the arbitrator. *Id.* at 9-10. Next, the Court determined that the arbitration agreement was part of a contract of adhesion and therefore had some element of procedural unconscionability. *Id.* at 15. Finally, the Court found that

the arbitration clause acted as an exculpatory clause in cases where claims were likely to be of low-value. *Id.* at 20.

In *Muhammad*, the Court distinguished its case from *Gras v. Associates First Capital Co.*, 346 N.J.Super. 42, 786 A.2d 886 (2001), *cert. denied*, 171 N.J. 445, 794 A.2d 184 (2002), which held that class action waivers in arbitration agreements are not *per se* unconscionable. Instead, the Court observed what it declared to be a crucial factual distinction, which merited a different result: "*Gras*, however, did not present the precise issue before the Court in this matter: whether the small amount of damages being pursued is this action involving complicated financial arrangements and multiple out-of-state entities effectively prevents plaintiffs from being able to vindicate the public interests protected by the CFA." *Id.* at 22.[3] Thus, the Court held that the class arbitration waiver at issue, which barred class arbitration in obviously low-value claims, acted as an exculpatory clause and, hence, was unconscionable and unenforceable under state law despite New Jersey's public policy favoring arbitration. *See Id.* at 20-23. As a result, here, where the Plaintiffs' claims involve low-dollar value consumer claims, both parties agree that the Agreement's class arbitration waiver clause is unconscionable under New Jersey law. However, Defendant argues that *Muhammad's* holding is

3. The New Jersey Supreme Court's ruling arguably makes all class arbitration waivers in consumer contracts involving low-value claims *per se* unconscionable and unenforceable.

inconsistent with, and therefore preempted by, the FAA. Moreover, Verizon cites the Third Circuit's recent decision in *Gay v. CreditInform*, 511 F.3d 369, 378 (3d Cir. 2007), as further and definitive support for that proposition. On the other hand, if *Muhammad* controls, the parties agree that Plaintiffs may proceed with this lawsuit, as opposed to pursing its class action in arbitration. *See* Pl. Opp. at 3; Df. Mot. at 9. Therefore, the issue before this Court is whether the FAA preempts the holding of *Muhammad* here.

The Third Circuit addressed this precise issue in *Gay*, where the court held that a state law determination that precludes, on unconscionability grounds, enforcement of an agreement to arbitrate low-value consumer claims on an individual basis is preempted by the FAA. 511 F.3d 369. In *Gay*, even though two Pennsylvania lower state court cases, *Lytle v. Citifinancial Services, Inc.*, 2002 PA Super 327, 810 A.2d 643 (Pa. 2002) and *Thibodeau v. Comcast Corp.*, 2006 PA Super 346, 912 A.2d 874 (Pa. 2006), supported the plaintiff's argument that the class arbitration waiver was unenforceable, the Third Circuit noted it was neither bound by these lower state court decisions, nor would it be bound even if they were Pennsylvania Supreme Court cases, because the Circuit was bound by "federal law that Congress set forth in the FAA" and state law "must conform with it." *Id.* at 393-94 n. 18. In that connection, the Circuit held that class waivers in arbitration agreements are "valid, irrevocable, and enforceable" under the FAA notwithstanding state law to the contrary. *Id.* at 394. Specifically, the court in *Gay*

held "[t]o the extent, then, that *Lytle* and *Thibodeau* hold that the inclusion of a waiver of the right to bring judicial class actions in an arbitration agreement constitutes an unconscionable contract, they are not based 'upon such grounds as exist at law or in equity for the revocation of any contract' pursuant to § 2 of the FAA, and therefore cannot prevent the enforcement of the arbitration provision in this case." *Id.* (citing 9 U.S.C. § 2). The Third Circuit applied the language of *§ 2* to class arbitration waivers and rejected the claim that such waivers are unconscionable. *See Id.* at 395. Instead, the Third Circuit held that the Commerce and Supremacy Clauses of the United States Constitution require the application of the FAA and the FAA strongly favors upholding arbitration agreements. *Id.* (citing U.S. Const., Art I, § 8 cl. 3; IV, cl. 2). Thus, the Circuit left very little room for this Court to invalidate an arbitration clause on the basis of a class waiver provision, even if it is unconscionable under state law.

That would seem to end the analysis here, but Plaintiffs argue that *Gay* does not require this Court to find that the FAA preempts *Muhammad*. Plaintiffs contend that the cases discussed in *Gay*, namely *Lytle* and *Thibodeau*, are distinguishable from *Muhammad* because *Muhammad* is "entirely neutral with respect to arbitration agreements," as the Court rejected class-litigation waivers generally, not just class-arbitration waivers; that the New Jersey Supreme Court decided *Muhammad* on general contract principles and did not demonstrate hostility to the arbitral forum, whereas the two Pennsylvania state cases found that an agreement

to arbitrate may be *per se* unconscionable. *See Gay*, 511 F.3d at 395; *Muhammad*, 189 N.J. at 22. That distinction does not hold water. "A court may not . . . in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law." *Perry*, 482 U.S. at 492. However, in *Muhammad*, the New Jersey Supreme Court only looked at a class arbitration waiver and did not look at broad class action waivers; the Court said:

> In this matter . . . there are two types of class-action waivers in the contracts Muhammad signed: the class-arbitration waivers and the broad class-action waivers. The broad class-action waivers could be considered distinct from the arbitration agreement in the contracts, and thus could be considered part of the 'contract as a whole.' . . . That situation is not before us, however, because there are distinct class-arbitration waivers, . . . [which] based on their location and subject matter[] are part of the arbitration agreements, and not part of the contracts as a whole.

Id. at 14. Further, although the Court, in *Muhammad*, stated that "[a]s a matter of generally applicable state contract law, it was unconscionable for defendants to deprive Muhammad of the mechanism of a class-wide action, whether in arbitration or in court litigation," *Id.*

at 22, nonetheless, the Court was not considering the validity of the broad class action waiver and considered the arbitration agreement separate from the contract. Thus, the Court's mention of "class-wide . . . in court litigation" is dicta. *Id.* Nevertheless, even if the *Muhammad* Court intended to rule that all class-action waivers of this nature were unconscionable, our conclusion would be the same because, in *Thibodeau*, the Pennsylvania court similarly held that "[t]he preclusion of class wide litigation or class wide arbitration of consumer claims, imposed in a contract of adhesion, [wa]s unconscionable and unenforceable." *See Thibodeau*, 912 A.2d at 886. The Third Circuit found that the FAA preempted this state law interpretation, despite the fact that the state court purported to reject the waiver of class treatment in general and not just in the context of arbitration clauses.

In *Gay*, the Third Circuit specifically addressed the issue of a seemingly neutral holding involving an arbitration agreement "written ostensibly to apply general principles of contract law" and ruled that "[a] finding that the arbitration provisions in [the Pennsylvania state] cases are unconscionable can be reached only by parsing the provisions themselves to determine what they provide." 511 F.3d at 395. The same can be said of the finding in *Muhammad*, as the New Jersey Supreme Court had to "pars[e] the provisions themselves to determine what they provide." *Id.* Under *Gay*, this appears to be enough to indicate that the New Jersey Supreme Court treats arbitration agreements differently from other contract provisions. Just as the

Circuit noted in *Gay*, the Plaintiffs here rely on the effect of the arbitration provisions to frame their unconscionability arguments: they "contend that the provision is unconscionable because of what it provides, i.e., arbitration of disputes on an individual basis in place of litigation possibly brought on a class action basis." *Id.* Thus, this Court is not persuaded by Plaintiffs' arguments that *Muhammad* is distinguishable from *Lytle* and *Thibodeau* such that this case is not subject to the holding in *Gay* that the federal law Congress set forth in the FAA "is controlling and the [state] law must conform with it." *Id.* at 393. Rather, I find that the facts of *Gay* itself belie the distinction Plaintiffs attempt to draw.

Plaintiffs also contend that the Pennsylvania state decisions did not set "definitive [state] precedent" binding the Third Circuit because *Lytle*, a Pennsylvania Superior Court case, was remanded for reasons related to class certification instead of the arbitration issue. The Third Circuit acknowledged that "*Lytle* and *Thibodeau* [we]re Superior Court cases and thus even if [the Third Circuit] were concerned with pure state law they would not bind [the Third Circuit]," but it further stated "that *even if they were Pennsylvania Supreme Court cases [the] result would [have been] the same.*" *Id.* at 394 n. 18 (citation omitted) (emphasis added). Similarly, *Muhammad* does not bind this Court, since the issue here is the FAA, a federal law, and "[New Jersey] law must conform with it." *Gay*, 511 F.3d at 393.

It is also of no consequence that *Muhammad* was decided under New Jersey law whereas *Lytle* and *Thibodeau* were interpretations of Pennsylvania law. In *Thibodeau*, a customer brought a class action lawsuit against a cable company claiming damages, also of such a minimal value that individual claims were unlikely to be brought, caused by subscribers being charged for equipment that they did not need. *See* 912 A.2d at 876. The customer agreement had an arbitration clause requiring individual arbitration and the court held that an arbitration agreement containing a class waiver, which Plaintiffs challenged, was unconscionable under Pennsylvania law. *Id.* at 878. *Muhammad* is similar to *Thibodeau* in its holding and its reasoning. The New Jersey Supreme Court, like the Pennsylvania courts, found that the clause acted as an exculpatory clause protecting the stronger party. *See Muhammad*, 189 N.J. at 6. Similarly, in the instant case, Defendant's arbitration clause acts to preclude class action in any forum and the claims in this case are also of low-value. While the holding in *Muhammad*, if controlling, would render Defendant's class arbitration waiver unconscionable under New Jersey law, the Third Circuit has already held that such an arbitration provision is enforceable under § 2 of the FAA. *See Gay*, 511 F.3d at 376. Indeed, the Circuit specifically analyzed the holdings in *Lytle* and *Thibodeau* to demonstrate why the FAA preempts state law; the Circuit concludes its discussion of the Pennsylvania cases by noting its obligation to "honor the intent of Congress" and "[i]f the reach of the FAA is to be confined then Congress and not the courts should be the body to do so." *Id.* at

395.[4] Applying *Gay's* holding, at least two courts in this circuit, in accordance with *§ 2* of the FAA, have compelled arbitration in cases where the facts surrounding the Agreement, arbitration clause, and class arbitration waiver are substantially similar to this case. *See Weinstein v. AT&T Mobility Corp.*, No. 07-2880, 2008 U.S. Dist. LEXIS 35666, 2008 WL 1914754 (E.D.Pa. April 30, 2008); *Halprin v. Verizon Wireless Services, LLC*, No. 07-4015, 2008 U.S. Dist. LEXIS 28840, 2008 WL 961239 (D.N.J. April 8, 2008).[5] Therefore, this Court too holds that, insofar as the FAA

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4. Plaintiffs also argue that *Gay* does not preempt *Muhammad* based on *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007), a class action involving a wireless company. *See* Pl. Opp. at 18. The Ninth Circuit held that "[t]he Federal Arbitration Act does not bar federal or state courts from applying generally applicable state contract law principles and refusing to enforce an unconscionable class action waiver in an arbitration clause." *Shroyer*, 498 F.3d at 987. While the Ninth Circuit has held that the FAA does not preempt state contract law principles invalidating class action waivers in arbitration clauses in these cases, this Court is subject to the binding precedent of the Third Circuit. *See also Stiener v. Apple Computer, Inc.*, No. 07-4486, 2008 U.S. Dist. LEXIS 90335, 2008 WL 1925197, at *3 (N.D.Cal. Apr. 29, 2008). In *Gay*, the Third Circuit held that the presence of a class arbitration waiver, even where it is unconscionable under state law, is not grounds for rendering an arbitration clause unenforceable. 511 F.3d at 394.

5. In *Weinstein*, the court denied the plaintiff's arguments regarding procedural and substantive unconscionability and granted the defendant's motion to compel arbitration; the court held that, pursuant to the Third Circuit's ruling in *Gay*, the

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FAA preempted the state court application of state law that held class waiver provisions in arbitration agreements unconscionable. *See* 2008 U.S. Dist. LEXIS 35666, 2008 WL 1914754 at *5.

In *Halprin*, dealing with a challenge to the class arbitration waiver in a Verizon customer service agreement, the court compelled arbitration in accordance with *Gay's* holding and application of the FAA. The *Halprin* Court found that it "must determine that the 'contract in general' is unenforceable, not just the individual 'agreement to arbitrate'" to invalidate a contract under state law pursuant to the language of the FAA. 2008 U.S. Dist. LEXIS 28840, 2008 WL 961239 at *6 (quoting *Gay*, 511 F.3d at 395). While the court applied Virginia state law when it declined to find the agreement unconscionable, it stated that it was "dubious that Plaintiff would prevail even under New Jersey's unconscionability rubic." *Id.*

Plaintiffs argue that the FAA does not preclude a state's use of substantive unconscionability to invalidate a class waiver in an arbitration agreement. As stated in *Muhammad*, under New Jersey law, the Court must consider both the procedural and the substantive unconscionability of an agreement. *See* 189 N.J. at 15. When considering this standard, the *Halprin* court stated: "[i]f an agreement is one of adhesion, where an agreement is 'presented on a take-it-or-leave-it basis,' then it indicates procedural unconscionability. In addition to considering the adhesive nature of a contract, the Court must also consider the subject matter of the contract, the parties' relative bargaining position, the degree of economic compulsion motivating the 'adhering' party, and the public interests affected by the contract." 2008 U.S. Dist. LEXIS 28840, 2008 WL 961239 at *7 (internal citations omitted). Given the facts presented here and the Third Circuit's decision in *Gay*,
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and *Muhammad* are inconsistent, federal law preempts the holding in *Muhammad*. *See* U.S. Const., Art IV, cl. 2.

Moreover, the Third Circuit has recently reinforced that the FAA establishes a strong federal policy in favor of resolution of disputes through arbitration and, absent fraud or misrepresentation, requires enforcement of arbitration clauses within agreements for which parties freely contract. *Morales v. Sun Constructors*, 541 F.3d 218, 2008 WL 3974059, at *2-3 (3d Cir. 2008). In *Morales*, the Third Circuit held that an employee, who was illiterate, was nevertheless bound by an arbitration clause in an employment agreement that he signed; "the fact that an offeree cannot read, write, speak, or understand the English language is immaterial to whether an English-language agreement the offeree executes is enforceable." 541 F.3d 218, *Id.* at *3. Rather, the court held that it was the plaintiff's obligation to ensure he understood the agreement before he signed it, even where he is ignorant of the language in which the agreement was written. *See* 541 F.3d 218,

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like in *Haplrin*, while the Agreement between Plaintiffs and Defendant bears the qualities of an adhesion agreement, the other factors do not indicate that the entire Agreement is substantatively unconscionable under the FAA; while Verizon clearly has more bargaining power as between the two parties, Plaintiffs were free to do business with any number of cell phone companies, choose not to obtain a cell phone, or discontinue their Verizon phone service. *See Id.* 2008 U.S. Dist. LEXIS 28840, at *6-7. Therefore, when looking at prior case law applying the FAA, this Court too finds it necessary to compel arbitration.

Id. at *4. *Morales* amply demonstrates the force of the presumption in favor of arbitration.

In this case, Plaintiffs are customers who chose Verizon as their wireless provider at least four years ago and continue to use Verizon today. They signed the customer Agreement with the arbitration clause and agreed to subsequent terms of service as added by Verizon. Plaintiffs do not allege that they did not understand the Agreement that they voluntarily entered into nor do they allege fraud or misrepresentation. The parties agreed "to settle [their] disputes . . . only by arbitration," Def.'s Mot. at Ex. A, CA-7, and the "agreement doesn't permit class arbitration." Def.'s Mot. at Ex. A, CA-8. Therefore, the FAA requires this Court to uphold the arbitration provision within Plaintiffs' service Agreement.[6] Since

6. The Court recognizes the many hardships visited upon plaintiffs, such as in this case, based upon this ruling. First, it creates the opportunity for a different result depending on whether the case is brought in federal or state court. Second, it is also clear that compelling individual arbitration in this case will be tantamount to ending the Plaintiffs' pursuit of their claims, as there is very little possibility that these Plaintiffs or any other plaintiff will pursue individual arbitration for claims that amount only to several dollars in damages. While this outcome is harsh, this Court is bound by Third Circuit precedent. As the *Gay* court noted, any other ruling "could result in a significant narrowing of the application of the FAA. We express no view on whether that might be a desirable result as it is not our function to do so. Rather, our obligation is to honor the intent of Congress and that is what we are doing. If the reach of the FAA is to be confined then Congress and not the courts should be the body to do so." 511 F.3d at 395.

the arbitration clause and class arbitration waiver are valid, Plaintiffs must bring their claims against Defendant through individual arbitration.

IV. Conclusion

For the foregoing reasons, Defendant's Motion to Compel Individual Arbitration is granted and the case is dismissed.

Dated September 29, 2008

/s/ Freda L. Wolfson
Honorable Freda L. Wolfson
United States District Judge